



Global Business & Development Law Journal

Volume 7

Issue 1 *Symposium: Doing Business in Central and Eastern Europe*

Article 9

1-1-1994

Legal and Policy Aspects of Private Foreign Investment in Nepal

Kishor Uprety
World Bank

Ruvan de Alwis
International Centre for Settlement of Investment Disputes (ICSID).

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Legal and Policy Aspects of Private Foreign Investment in Nepal

Kishor Uprety*
Ruvan de Alwis**

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* A Nepalese national, Mr. Uprety has a law degree from Tribhuvan University (Nepal) and a LL.M., D.E.S.S., and a Doctor of Laws Degree from the University of Sorbonne, Paris. Mr. Uprety has worked as a legal officer at the Royal Nepal Academy of Science and Technology, as Lecturer of Law at the Faculty of Law, Tribhuvan University, and as lawyer at the International Fund for Agricultural Development (Rome). Presently he is counsel at the World Bank. Mr. Uprety has published three books and a number of articles.

** Consultant, International Centre for Settlement of Investment Disputes (ICSID). B.A., American University (1987); M.A., George Washington (1989); LL.B, Colombo (Sri Lanka) (1991); LL.M. Georgetown (1993).

This article represents the views of the authors and does not necessarily reflect the views of the institutions with which they are associated.

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I. INTRODUCTION

The assessment of local investment conditions invariably precedes an investor's decision to make an investment in a country. Language and cultural differences can make this a particularly difficult undertaking for foreign investors.¹ Thus, the objective of this paper is to identify the relevant Nepalese legal requirements and policies in order to facilitate such assessments by prospective investors.

Nepal is a small, landlocked country bordered by the Tibetan region of China in the north and India in the east, south, and west. Its history is distinct. Never having been under foreign domination, Nepal has always maintained an independent sovereign status. Since its admission to the United Nations in 1955, Nepal has pursued a nonaligned foreign policy.²

From an economic perspective, Nepal is classified as a less-developed country, with a per capita income of \$170 per year, low manufacturing in gross domestic product (GDP) and low indices in the social indicators of development.³ In order to improve its status, Nepal needs to import capital, as well as technical,

1. This point becomes even more important in the case of many developing countries where the "rule of law" principle is somewhat shaded by the whims of the administrative machinery. Indeed, some authors have emphasized that apart from the written laws which are the principal framework for regulating foreign investment, there is also another level of law, that which is unwritten. This level is the "way things work," the "operational code" consisting of unpublished regulations and rulings which are applied in some cases, but not even mentioned in others. See R. FOLSOM ET AL., *INTERNATIONAL BUSINESS TRANSACTIONS* 259 (4th ed. 1992).

2. For further information, see MINISTRY OF INDUS., FOREIGN INV. PROMOTION DIV., *NEPAL FOREIGN INVESTMENT OPPORTUNITIES* 6 (July 1992) [hereinafter *FOREIGN INVESTMENT OPPORTUNITIES*].

3. *ECOSOC: Committee for Development Planning Report on the Seventh Session*, 51st. Sess., Supp. No. 7, at 19, U.N. Doc. E/4990 (1971). Manufacturing is 9.88% of GDP. *FOREIGN INVESTMENT OPPORTUNITIES*, *supra* note 2, at 7. See WORLD BANK, *NEPAL: PUBLIC RESOURCES MANAGEMENT IN A RESOURCE-SCARCE ECONOMY* § i (1992).

marketing, and management expertise.⁴ As a prerequisite, Nepal needs to develop a legal and administrative framework which would permit such capital imports.

This article will provide the legal background to, and principal sources of information on the emerging role of and environment for private foreign investment in Nepal. The main focal point of discussion, therefore, will be the laws that govern foreign investment.⁵ This article will also address specific government policies that have an impact on the economic development of Nepal.⁶

It should be noted at the outset that the second half of the 1980s have been overwhelmed by substantial changes. Traditional state participation in the economy was largely discontinued. Drastic liberalization processes were initiated, and in most cases, were affirmed through legal and policy adjustments. For decades, Nepal was treating symptoms, not causes. The basic cause was obvious but never admitted—the legal and policy environment was not suitable for the promotion of foreign investment.

The first part of this article will lay the groundwork by discussing the importance of private foreign investment in the national context as well as the government attitude toward foreign capital and technology as a whole.⁷ It will analyze the national legal and policy framework in which foreign capital and technology are to be imported. In this context, this article will not only discuss the provisions of the existing laws dealing with foreign investment, but will also analyze the benefits and burdens of such laws. It should also be noted that the Nepalese efforts to attract foreign investment have been substantially dominated by the national need to import foreign technology.⁸ The second part of this article will analyze the pattern and forms of technology transfer as well as the disequilibrium that exists in the transactions between private foreign investors and local partners.⁹ Finally, this article will examine “what the laws ought to be” and not merely “what the laws are.”¹⁰ This approach will take into account the obvious discrepancies between the laws and the practices which, in fact, have resulted in a situation of quasi-nonapplication of most provisions of the existing laws.

In order to better understand the efforts made by Nepal to foster bilateral investment relations and to assess the real outcome of such endeavors, this article will also discuss the bilateral agreements that Nepal has signed with France, Germany, the United Kingdom, and the United States.¹¹ This is essential because of the relative importance of such countries in the investment operations in Nepal.

4. NAT'L TRADE DATA BANK, 1992 MARKET REPORTS 3 (Nov. 13, 1992).

5. See discussion *infra* part II.

6. See discussion *infra* parts II, III.

7. See discussion *infra* part II.

8. See FOREIGN INVESTMENT OPPORTUNITIES, *supra* note 2, at 10.

9. See discussion *infra* part III.

10. See discussion *infra* part IV.

11. See discussion *infra* part II.C.6.

While assessing the impact of these agreements on the national investment scene, this article will also consider the status of Indian investments in Nepal, which benefit from the provisions of a peace and friendship treaty.¹²

Since the political changes of 1951,¹³ the Nepalese economy has been, in theory, an open market economy. However, in practice it may have remained sporadically controlled.¹⁴ Since the early 1980s, especially since 1985, the pace of liberalization has been more easily discernible. The government started to gradually encourage private sector involvement in the national economic development and industrialization process.¹⁵ Until 1985, the role of the private sector was limited by government policy. However, beginning with the sixth and the seventh development plans,¹⁶ special encouragement was granted to this sector. The government policy regarding the private sector was made clear:

The private sector will be given the first opportunity of promoting the development of industry through investment. Only if the private sector does not respond to meet the investment program, the government of His Majesty and the governmental agencies intervene by way of investment. Even under these circumstances, His Majesty's government will pursue a policy of disinvestment in favor of the private sector as and when the climate for this is appropriate.¹⁷

This policy regarding the private sector gradually evolved toward liberalism.¹⁸ The New Industrial Policy of 1992 sets forth that "in order to create an environment necessary to enable the private sector to play a principal role in the industrialization endeavor of the country, the public sector industries will mostly

12. See *infra* notes 99-100 and accompanying text (discussing the Indo-Nepal Treaty in detail).

13. From 1846 to 1951, the kingdom of Nepal was ruled by prime ministers from the same family, the Ranas. They virtually imprisoned the kings and enjoyed absolute legislative, executive, and judicial power. This oligarchical regime of prime ministers was overthrown in 1951 by a popular movement and the monarchy was restored. For a general account, see P. L. YADAV, *THE POLITICAL HISTORY OF NEPAL* (1988). See also Michael Hutt, *Drafting the Nepal Constitution, 1990*, *ASIAN SURV.*, Nov. 1991, at 1021.

14. Indeed, as admitted by the minister of finance, the economy of Nepal is beset with many structural problems and economic anomalies. See *Summary of Proceedings, in WORLD BANK ANNUAL MEETING OF THE BOARD OF GOVERNORS* 127 (1991) (statement of M. Acharya).

15. For detail on the performance of the industrial sector, see *WORLD BANK COUNTRY STUDY, NEPAL: POLICIES FOR IMPROVING GROWTH AND ALLEVIATING POVERTY* 33-34 (1989).

16. The sixth development plan occurred during 1980-85, and the seventh occurred during 1985-90. Nepal embarked on a program of planned economic development as early as 1956. Since then, seven development plans have been implemented, and the eighth, covering the period of 1992-97, is currently being implemented.

17. Policy No. 1, reprinted in *GOV'T OF NEPAL, MINISTRY OF INDUS., INDUSTRIAL POLICY OF THE GOVERNMENT OF NEPAL* (1987) [hereinafter *INDUSTRIAL POLICY*].

18. The government has embarked on a policy of privatization of its 60 public enterprises. In 1992 three industrial enterprises and five firms were privatized. The general policy is that foreign investors will also be allowed to bid on public firms that are privatized in the future. See *NAT'L TRADE DATA BANK, supra* note 4, at 10.

be privatized and no private sector industries will be nationalized.”¹⁹ The new policy further emphasizes:

The government will make no interference in fixing the price of industrial products other than creating an open and competitive atmosphere. If necessary, during the initial period of industrialization, the government may establish, in the form of joint ventures either with the national or foreign private sector or foreign governments, some of the industries which the private sector is reluctant to set up but that are essential for the national economy as a whole.²⁰

Further, “the shares owned by government and public sector corporations of such industries will also be gradually transferred to private sector.”²¹ This clearly demonstrates that government involvement is only a last resort.

Nepal is an agricultural country; industry provides only a little more than thirteen percent of GDP and employs fewer than 150,000 workers.²² About thirty percent of the industrial sector belongs to the State.²³ The private sector contributes about five percent of the gross national product (GNP) and employs just over one percent of the active population.²⁴

The relatively low participation of the private sector is also a product of the lack of resources. Therefore, the government has been emphasizing the importance of private foreign capital and investment since the middle of the 1970s.²⁵ It clearly understood that in order to reduce imports and increase exports it was essential to industrialize the country, and thus a favorable climate for foreign investors was required.²⁶

19. GOV'T OF NEPAL, NEW INDUSTRIAL POLICY pmbl. (1992).

20. *Id.*

21. *Id.* This statement of the policy tends to give the false impression that private foreign investment is only permitted in the industrial sector. This unfortunate confusion stems from the use of the word “industry” in Nepalese law and policy in an ambiguous manner. Private foreign investment is generally possible in all primary, secondary, and tertiary sectors for all industrial, trade, finance, and insurance activity. *See infra* notes 35-51 (describing the classification of industries and the monitoring of foreign investment). Foreign banks, however, may only operate in the form of a joint venture with a local Nepalese bank. Wholly owned foreign banks and branches of foreign banks cannot be established. *See* U.N. CTC, NATIONAL LEGISLATION AND REGULATIONS RELATING TO TRANSNATIONAL CORPORATIONS, Vol. 7, at 113, U.N. Doc. ST/CTC/91 (1991) [hereinafter NATIONAL LEGISLATION].

22. This figure seems low, but this is because about 750,000 “cottage industries” that employ over one million people are not included in this count. *See* THE RISING NEPAL, Mar. 1988.

23. GOV'T OF NEPAL, THE INDUSTRIAL STATISTICS 15-16 (1988).

24. *Id.* The total population of Nepal is 18.9 million. WORLD BANK, WORLD DEVELOPMENT REPORT 220 (1992). The latest estimates place the population at 20 million. THE WORLD ALMANAC AND BOOK OF FACTS 1994, at 793 (1994).

25. For more detailed information, see generally the development plans implemented by the Nepal government, *supra* note 16.

26. *See generally* NAT'L TRADE DATA BANK, *supra* note 4, at 3.

II. FOREIGN INVESTMENT REGIME

The framework that governs foreign private investment in Nepal is a complex labyrinth of constitutional provisions, legislative acts, and policy directives. In addition to an act which was passed to regulate foreign investment,²⁷ several other laws designed to govern domestic investment are also applicable.

A. *Constitution of Nepal*

The constitution of Nepal provides the following directive regarding foreign investment:

The State shall for the purpose of national development adopt necessary means for the attraction of foreign capital and technology while at the same time promoting indigenous investment.²⁸

The language clearly states that foreign investment is sought to complement domestic savings, as well as to bridge the technology gaps. While the importance of foreign capital is not minimized, the mobilization of local resources for investment is also emphasized. This constitutional provision reflects an inclination toward a "controlled" or "geared" investment policy.

Nevertheless, while the policies contained in the constitution are considered fundamental to the activities and governance of the state,²⁹ they remain unenforceable in the courts.³⁰

B. *Evolution of Policy*

The 1987 Industrial Policy of the Nepalese government contained the three objectives of the country's industrial program. It stated that foreign investment was encouraged "to promote capital inflow, generate technical expertise, and improve productivity."³¹ The Industrial Policy also stated that relevant technology was to be imported, while taking into account the socioeconomic situation of the country and the rate at which new methods and concepts could be absorbed.³² This Policy emphasized the three elements required for industrializa-

27. The Foreign Investment and Technology Act (1982) (Nepal) [hereinafter FITA].

28. NEPAL CONST. art. 26(12), pt. 4 (1990) (entitled "Directive Principles and Policies of the State").

29. See NEPAL CONST. art. 24(2) (stating that the principles and policies shall be implemented in stages through laws within the limits of the resources and the means available in the country). This, indeed, makes possible the argument that the constitutional provision has merely the value of a guideline for the country.

30. NEPAL CONST. art. 24(1) (stating "The principles and policies contained in this part shall not be enforceable in any court.").

31. Policy No. 6, reprinted in INDUSTRIAL POLICY, *supra* note 17.

32. Policy No. 7, reprinted in INDUSTRIAL POLICY, *supra* note 17.

tion: capital, technical knowledge, and production. At the same time, it advocated controlled investment practices for the country. Indeed, the government has been in favor of a balance between foreign and local investment.³³ This balance is also endorsed by the New Industrial Policy of 1992, which states that the objective of the policy is "to adopt appropriate policy conducive to industrialization for the balanced regional development of the country."³⁴

C. Legislative Bases

The laws that govern foreign investment in Nepal are interwoven with the national policies on industrial development and foreign trade. These policies generally give priority to import substitution and export promotion.

The regime of foreign private investment in Nepal is based principally on two legislative acts: the Industrial Enterprises Act of 1982,³⁵ and Foreign Investments and Technology Act of 1982.³⁶ Both of these Acts should be considered in order to understand the applicable regime.³⁷

1. Classification of Industries

The Foreign Investment and Technology Act and the Industrial Enterprises Act permit foreign investment by individuals, natural persons or corporate bodies, and groups or international organizations.³⁸ The percentage of ownership allowed can be a majority shareholding in medium-size industries and 100 percent in

33. This seems to stem from the Nepalese approach which, in the words of R. Goode, can be termed "industrialization with dualism," but which calls for active government policies to promote a modern industrial sector to coexist with a traditional sector of agriculture, handicrafts, and small trade. See R. GOODE, *GOVERNMENT FINANCE IN DEVELOPING COUNTRIES* 257 (1986).

34. GOV'T OF NEPAL, *NEW INDUSTRIAL POLICY*, *supra* note 19, para. 1.4.

35. The first Act establishing the regime for industrial enterprises was offered on May 28, 1961. Industrial Enterprises Act (1961) (Nepal). It was subjected to a series of changes and amendments. In 1982, the Act was completely rewritten to conform to the new industrial policy adopted by the government. Industrial Enterprises Act (1982) (Nepal) [hereinafter Industrial Enterprises Act]. In 1987, a few minor amendments were also introduced.

36. Text of the act reproduced in ICSID, *6 INVESTMENT LAWS OF THE WORLD* (1984).

37. Apart from these two acts, a number of other laws affect foreign investment, but this paper is limited to the general study of the acts that deal more directly with investment. Other acts that are indirectly linked with a foreign investment venture are, *inter alia*, the Company Act, Taxation Act, Foreign Exchange Act, Export Import Act, Commercial Bank Act, Central Bank Act, Labor Act, Bonus Act, Factory and Factory Workers Act, and Mines Act. All these acts are closely related to the establishment and operation of industries and have necessary relevancy to foreign investment. See D.B.S. Thapa, *The Legal System of Nepal*, in 9 *MODERN LEGAL SYSTEMS CYCLOPEDIA* 9.240.28 (1990). Moreover, for the purpose of providing licensing procedures and concessions to foreign investors in extracting petroleum in Nepal, a separate Petroleum Act was promulgated in 1985. *Id.*

38. FITA, *supra* note 27, § 2(e). However, because of unclear provisions in the law on ownership by aliens, and for other reasons, foreign investments are made through corporations created for this purpose. Indeed, law covering the right to private ownership of foreign, private entities is confusing. While foreign private entities do not have the right to own land, foreign companies can own land and build on it.

heavy industries.³⁹ In selected “vital” industries, however, foreign investments are excluded. For example, industries engaged in the manufacture of arms, ammunition, cartridges, and explosives may be established and operated only by the government.⁴⁰

The Industrial Enterprises Act, as amended, defines and establishes a classification of industries. The classification takes into account the capital invested, fixed assets, and the location of the industry.⁴¹ Industries that allow the participation of foreign investors are included in two categories: medium-scale and large-scale industries.⁴²

According to the Industrial Enterprises Act, medium-scale industries are those in which investment in fixed assets exceeds NR 10 million⁴³ but does not exceed NR 50 million. Large-scale industries are those in which investment in fixed assets exceeds NR 50 million.⁴⁴

An industrial concern may be organized and registered as a private limited company or public limited company.⁴⁵ As a matter of general theory, two forms of direct foreign investment—equity joint venture or wholly owned ventures—are possible; however, the practice is to encourage joint ventures.

Under the Industrial Enterprises Act, industries may also be classified on the basis of their activities. For instance, there are manufacturing industries that use, reuse, or process raw material, semiprocessed materials, and by-products or waste materials; energy-based industries that engage in harnessing energy from water resources, the sun, coal, natural oil and gas, and biogas; agro-based industries that are involved in animal husbandry, poultry production, pisciculture, dairy farming, beekeeping, and sericulture; mining industries that deal with mines and minerals; tourism industries that involve, inter alia, tourist cottages, motels, hotels, restaurants, bars and travel agencies; service industries that concern the sectors of transportation, construction, repair and maintenance, printing press, industrial counseling, hospitals, and nursing homes; recreational industries that concern cultural

39. One hundred percent of foreign equity participation in large industries is allowed only if 90% of the total output is to be exported; otherwise, foreign equity participation remains limited to 80%. *See generally* NATIONAL LEGISLATION, *supra* note 21, at 110-12. In cases where the 20% allotted to local investors is not used, foreign equity participation may be increased. *Id.*

40. Industrial Enterprises Act, *supra* note 35, § 6. Since 1992, cigarettes and alcohol (unless 100% is exported or yeasted) are also prohibited from a grant of approval under foreign investment. NEW INDUSTRIAL POLICY, *supra* note 19, annex 1.

41. *See* Industrial Enterprises Act, *supra* note 35, § 2.

42. GOV'T OF NEPAL, MINISTRY OF INDUS., FOREIGN INVESTMENT AND ONE-WINDOW POLICY para. 4.2 (1992) [hereinafter FOREIGN INVESTMENT AND ONE-WINDOW POLICY].

43. Ten million Nepalese rupees (NR) is approximately \$225,000. One U.S. dollar is roughly equivalent to NR 45.

44. *See* Industrial Enterprises Act, *supra* note 35, § 2(d)-(e). *See also* FITA, *supra* note 27, §§ 2(a); NEW INDUSTRIAL POLICY, *supra* note 19, para. 4.3.

45. For the main forms of business organizations, *see* NATIONAL LEGISLATION, *supra* note 21, at 123-25.

activities, cinemas and circuses; and assembly industries based on using end-use goods by putting together and assembling various parts and components.⁴⁶

2. Monitoring and Screening of Foreign Investment

The government policy on foreign investment requires that a foreign investment venture fulfill certain criteria.⁴⁷ While ruling on a request for a permit for such an investment enterprise, the government examines such issues as whether the proposed venture is useful for the country, whether it will improve the balance of trade, whether it will create job opportunities and management training, and whether the project or any related transfer of technology is contradictory to existing Nepalese law.⁴⁸ Any foreign investor acting independently or jointly with a Nepalese national to establish a joint venture is required to submit an application to obtain permission for such a venture.⁴⁹ The permission is granted on the recommendation of the Industrial Promotion Board.⁵⁰ Thus, the government maintains a firm grip on the formation of new enterprises. Indeed, at this point, one can see an ambivalence in the governmental attitude towards private foreign investment. While the country needs to promote foreign investment which is consistent with its developmental priorities, government practices show that an excessive amount of consideration is given to the nationalities or origin of the investors or the investment, the activities undertaken, the openings in the market, and the like.⁵¹

46. For details on the classification, see Industrial Enterprises Act, *supra* note 35, § 9. See also NEW INDUSTRIAL POLICY, *supra* note 19, para. 4.

47. FITA, *supra* note 27, §§ 3, 5.

48. *Id.* § 5.

49. *Id.* § 3.

50. *Id.* § 4. For details, see NEPAL TRADE BULLETIN (Gov't of Nepal, Trade Promotion Center), 1981, vol. 7, no. 1.

51. Prior to the beginning of 1992, before the authorization from the Ministry of Industry, each investment venture was required to obtain a recommendation from the ministries or departments concerned. For instance, a venture related to mines or minerals required a recommendation from the Department of Mines, a venture in communications required a recommendation from the Ministry of Communications, and so on. This requirement, which substantially delayed the process, was streamlined in 1992 through the introduction of a "one window policy." This allowed the investor to deal with only one governmental organization. This conclusion is based on the personal observations and experiences of the authors. According to this policy, foreign investors must apply for a license on a prescribed form; then, the industrial promotion board must decide whether to grant the license within 30 days. Once a license has been granted, the Department of Industry has authority to meet the needs of investors regarding water supply, electricity and telecommunications facilities, imports of machinery, raw materials and spare parts, issue of import licenses, release of foreign currency, and other facilities as required. NEW INDUSTRIAL POLICY, *supra* note 19. See generally FOREIGN INVESTMENT AND ONE-WINDOW POLICY, *supra* note 42. Also, regarding the same streamlining process, a Company Registrar's Office started functioning on January 25, 1994 to register companies under the 1964 Company Act; this is a function previously performed by the Department of Industry. See THE RISING NEPAL, Jan. 28, 1993.

3. *Facilities and Incentives*

The 1982 amendment to the Industrial Enterprises Act grants fiscal and tax incentives and privileges to foreign investors.⁵² Among the privileges are full or partial concession on the exemption of income tax,⁵³ customs duty facilities,⁵⁴ and exemption of excise duty or sales tax as well as foreign exchange facilities.⁵⁵ Moreover, according to the laws in force, the foreign investors are entitled to concessions such as reduced electricity tariffs or lower interest rates.⁵⁶

The Industrial Enterprises Act also states that the government may provide protection to an enterprise either by quantitative or full restriction on imports or by imposing higher tariffs on imported goods (throughout the country or on a regional basis). This protection depends on the financial position, production capacity, product qualities, and price competitiveness of the enterprise.⁵⁷ Indeed, such controls should be justified by economic or business conditions. Once an industry is established in Nepal, a foreign private investor can benefit from the protection that the government grants to all investment enterprises.⁵⁸

Similarly, if the industries successfully compete in an international bidding process and sell their products within the kingdom, such a sale is treated as an export to foreign countries. These industries are accorded the additional incentives and facilities granted to exporting industries.⁵⁹ The foreign investment enterprise would also be entitled to such incentives and facilities without discrimination.

4. *Repatriation of Capital*

There are currently no limitations on the repatriation of profits, capital gains, royalties, and the like. Procedures for transferring currency, although difficult and lengthy, exist. The remittances are made through foreign exchange permits granted by the Central Bank.⁶⁰

52. For the details on incentives and privileges granted to foreign investors, see NATIONAL LEGISLATION, *supra* note 21, at 117-23. See also K. UPRETY, *LE NEPAL ECONOMIE ET RELATIONS INTERNATIONALES* 234-37 (1985).

53. Industrial Enterprise Act, *supra* note 35, § 10(a).

54. *Id.* § 10(b).

55. *Id.* §§ 10(c)-(e).

56. *Id.* §§ 10(g)-(h).

57. *Id.* § 10(k)1.

58. However, the protection available under the Industrial Enterprises Act is not exclusively granted to foreign investors.

59. Industrial Enterprises Act, *supra* note 35, § 10(k)2.

60. GOV'T OF NEPAL, MINISTRY OF INDUS., FOREIGN INVESTMENT OPPORTUNITIES (July 1992). On February 10, 1993, the Nepal government decided to make the Nepalese rupee fully convertible. Prior to this, for nearly a decade, Nepal was employing a system of partial convertibility with 75% of the exchange rate determined by the free market rate of the currency and 25% fixed at the government rate. The new exchange rate system will, in due course, ease the problems linked with the repatriation of capital.

Section 10 of the Foreign Investment and Technology Act permits foreign investors "in certain situations" to repatriate dividends, amounts necessary for payment of interest or repayments of foreign loans, amounts received under a technology transfer agreement, and amounts received as compensation for the nationalization or acquisition of property. The government policy also allows foreign experts working in Nepalese industries—with prior approval from countries where convertible currencies are in circulation—to repatriate in convertible currency, up to seventy-five percent of their salaries, allowances, and other earnings.⁶¹

The policy also states that the Nepalese government, in special circumstances, shall have the right to restrict such payments in amount or to require their payment in installments.⁶² However, the Act does not define such "special circumstances." The interpretation, unfortunately, is left entirely to the government.

5. *Applicable Law and Settlement of Disputes*

In their investment decisions, private investors, whether domestic or foreign, take into account such questions as whether the legal system gives investors rights that are routinely enforced, and whether disputes arising from their activities will be resolved in an evenhanded, expeditious, and efficient manner.⁶³

In Nepal, when a foreign investor suffers damages, the first recourse is usually under the "national jurisdiction," which is entirely the product of Nepalese law in procedure and substance. There are also mechanisms of international arbitration which allow the parties to create an international tribunal of specialists where they are equally represented; this tribunal then applies the laws of their choice.⁶⁴

61. FOREIGN INVESTMENT AND ONE-WINDOW POLICY, *supra* note 42, para. 5.6.

62. *Id.*

63. See I.F.I. Shihata, *Judicial Reform in Developing Countries and the Role of the World Bank*, in SEMINAR ON JUSTICE IN LATIN AMERICA AND THE CARIBBEAN IN THE 1990S (Inter-Am. Dev. Bank, San Jose, Costa Rica), Feb. 1993, at 4.

64. Nepal's commercial law is not well developed and the courts are overburdened. Laws protecting property rights and enforcement of contracts are especially inadequate. Therefore, negotiations are considered to be more effective than litigation in resolving investment disputes. For details, see NAT'L TRADE DATA BANK, *supra* note 4.

Indeed, as noted by Shihata, "Serious investors look for a legal system where property rights, contractual arrangements and other lawful activities are safeguarded and respected, free from arbitrary governmental action and from pressure by special interest groups or powerful individuals." Shihata, *supra* note 63, at 4.

Apparently, the definition of property rights in the context of private, foreign investment seems important. However, as indicated by some authorities, all municipal laws do not necessarily recognize property rights in a similar manner. While developed countries with market-based economies attach greater importance to individual property rights, the countries in the south are far from being attached to it. D. CARREAU ET AL., *DROIT INTERNATIONAL ECONOMIQUE* 670 (3rd ed. 1990).

Paradoxically, it is the countries of the south that need international investment for their development. The municipal laws that most efficiently protect property rights are in countries that need foreign investment the least, whereas municipal laws that inadequately protect property rights are in countries that need international

The Foreign Investments and Technology Act states that when disputes cannot be settled amicably, arbitration shall take place.⁶⁵ The Act does not specify any detailed provision for arbitration except that the parties may demand the arbitration be governed by UNCITRAL rules, which provide that arbitration will be conducted in Nepal, and the Nepalese laws shall remain applicable.⁶⁶

In this context, it is important to note that such arbitrations will fall under the Arbitration Act.⁶⁷ Among other provisions, the Act covers the number of arbitrators,⁶⁸ procedures for appointment of arbitrators,⁶⁹ eligibility,⁷⁰ hearings and arbitral procedures,⁷¹ representation,⁷² content of the arbitral award,⁷³ annulment of award,⁷⁴ and enforcement of foreign arbitral awards.⁷⁵

6. Investment Guarantees and Bilateral Arrangements

As mentioned above, foreign investments in Nepal are governed by the Industrial Enterprises Act and the Foreign Investments and Technology Act. However, investors generally prefer to have additional guarantees such as those provided through bilateral or multilateral agreements. In addition to dealing with a guaranty as such, it is also believed that an investment agreement between states provides a general framework that is complemented by particular investment contracts.⁷⁶

The Nepalese government signed bilateral agreements with the United States in 1960, France in 1983, Germany in 1986, and the United Kingdom in 1993. The main features of these agreements are presented below.

investment the most. *Id.*

65. See FITA, *supra* note 27, § 17(a). As a matter of practice, contracts between foreign investors and Nepalese parties now customarily contain arbitration clauses. The applicable law in such contracts is always the law of Nepal.

66. *Id.* § 17(b).

67. Arbitration Act (1982) (Nepal). The act states that "any dispute arising out of a bilateral or multilateral agreement may be settled through arbitration." *Id.* § 3.

68. *Id.* § 4.

69. *Id.* § 5.

70. *Id.* § 8.

71. *Id.* §§ 11-15.

72. *Id.* § 16.

73. *Id.* § 19.

74. *Id.* § 21.

75. *Id.* § 24.

76. For details, see Patrick Juillard, *Les conventions bilatérales d'investissements conclues par la France*, 106 JOURNAL DU DROIT INTERNATIONAL 274 (1979).

a. *U.S.-Nepal Agreement*

On May 17, 1960, in Washington D.C., a guaranty agreement was concluded between Nepal and the United States.⁷⁷ On June 4, 1963, the agreement was modified to provide expanded coverage. This agreement covers claims, dispute resolution, and force majeure.

The agreement offers specific risk guarantees for American investors in Nepalese projects approved by the government of Nepal⁷⁸ against non-convertibility of currency,⁷⁹ expropriation, confiscation, or loss from war, revolution, or insurrection.⁸⁰ The agreement also makes available, in special cases, extended risk guarantees against loss of an investment. This covers any risk, including normal business risks other than fraud or misconduct, for which the investor is responsible or normally would be insured against, such as fire or theft. The first type of guarantee provides reimbursement of the full investment by the U.S. government; the second type offers reimbursement of an agreed share.

The U.S.-Nepal Agreement also has provisions for dispute resolution specific to the investment. These provisions are complex but give specific directions for handling a dispute.⁸¹

Two decades later, in the process of expanding bilateral investment relations, and in order to protect investments from France, Germany, and the United Kingdom, Nepal entered into agreements with these three countries. The main features of these arrangements are briefly presented in the following paragraphs.

b. *Investment Relations with France, Germany, and the United Kingdom*

In order to develop economic cooperation between France and Nepal and to create favorable conditions for French investment in Nepal and corresponding Nepalese investment in France, the two governments concluded an agreement on

77. Exchange of Notes Constituting an Agreement Relating to the Guaranty of Private Investments, May 17, 1960, U.S.-Nepal, 11 U.S.T. 1396 [hereinafter U.S.-Nepal Agreement] (entered into force May 17, 1960).

78. *Id.* art. 3.

79. *Id.* art. 3, para. (b).

80. *Id.* art. 3, paras. (b), (d), (e).

81. See generally *id.* art. 3, para. (c). Generally, any claim against the government of Nepal to which the U.S. government may be subrogated as a result of any payment under a guaranty is subject to direct negotiation between the two governments. *Id.* If the claim cannot be settled within a reasonable period, it is to be referred for final and binding determination to a sole arbitrator selected by mutual agreement. *Id.* If within a period of three months the governments are unable to agree upon the selection of the arbitrator, either government may request the president of the International Court of Justice to intervene and designate an arbitrator. *Id.* The rules for arbitration of claims provided for by this agreement are not applicable against losses by reason of war. *Id.* art. 3, para. (e).

May 2, 1983.⁸² Similar arrangements were made by the governments of Germany and Nepal on October 20, 1986,⁸³ and by the governments of the United Kingdom and Nepal on March 2, 1993.⁸⁴

Apart from minor differences in presentation, the agreements treat foreign investment in a similar spirit. All three encourage investment made by the nationals or companies of the other country within their territory or within their maritime zones. Privileges similar to those of most-favored nations are granted to nationals and companies, and appropriate facilities are granted for personal activities. The principle of equal treatment is clearly spelled out. Each contracting party grants equal and just treatment for investment by nationals and corporate bodies from the other contracting party.⁸⁵ The France-Nepal agreement also adds that the exercise of such recognized rights will not be subjected to any hindrance, either in law or in act.⁸⁶ Similarly, all these agreements allow free transfer of funds.⁸⁷

The France-Nepal Agreement, the Germany-Nepal Treaty and the U.K.-Nepal Agreement provide for full protection of investment against expropriation or nationalization. They clearly state that no state shall take measures to nationalize or expropriate the foreign investment without adequate indemnifications.⁸⁸

Regarding settlement of investment disputes, the France-Nepal Agreement, the Germany-Nepal Treaty, and the U.K.-Nepal Agreement provide a detailed mechanism. Dispute resolution follows two steps. The first step provides for an amicable settlement of the dispute. The second step provides for referral to the

82. Accord entre le Gouvernement de la Republique Française et le Gouvernement de sa Majeste le Roi du Nepal sur l'Encouragement et la Protection Reciproques des Investissements, May 2, 1983, Fr.-Nepal, Journal Officiel de la Republique Française 8104 (Jul. 18, 1985) [hereinafter France-Nepal Agreement].

83. Treaty Between the Federal Republic of Germany and the Kingdom of Nepal Concerning the Encouragement and Reciprocal Protection of Investments, Oct. 20, 1986, F.R.G.-Nepal, BGBl. II 262 (Mar. 17, 1988) [hereinafter Germany-Nepal Treaty].

84. Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and His Majesty's Government of Nepal for the Promotion and Protection of Investments, Mar. 2, 1993, U.K.-Nepal, U.K.T.S. No. 55 (Cmd. 2327) (1993) [hereinafter U.K.-Nepal Agreement].

85. France-Nepal Agreement, *supra* note 82, art. 3; Germany-Nepal Treaty, *supra* note 83, art. 3; U.K.-Nepal Agreement, *supra* note 84, art. 3.

86. France-Nepal Agreement, *supra* note 82, art. 3.

87. France-Nepal Agreement, *supra* note 82, art. 6; Germany-Nepal Treaty, *supra* note 83, art. 5. An interesting contradiction can be noticed. According to the FITA, the government of Nepal has the right to decide on allowing the funds to be transferred on an installment basis only. *See supra* notes 60-62 and accompanying text (describing the repatriation of capital). The free flow of funds is not completely "free" legally, and therefore, there is a clear conflict between domestic law and the agreements.

88. France-Nepal Agreement, *supra* note 82, art. 5; Germany-Nepal Treaty, *supra* note 83, art. 4; U.K.-Nepal Agreement, *supra* note 84, art. 5. Moreover, the measures taken to nationalize or expropriate, if necessary, should be relevant only for public utility purposes. France-Nepal Agreement, *supra* note 82, art. 5; Germany-Nepal Treaty, *supra* note 83, art. 4; U.K.-Nepal Agreement, *supra* note 84, art. 5.

International Centre for Settlement of Investment Disputes if the dispute cannot be resolved amicably.⁸⁹

The agreements also provide an arbitration mechanism to settle conflicts in the interpretation or application of the agreements if the problem is not solved through diplomatic means.⁹⁰ For arbitration, each country appoints a member to the arbitral tribunal.⁹¹ The two members appoint the president of the tribunal.⁹² The decision of the tribunal is binding.⁹³

A review of these legal arrangements leads to consideration of at least two points. First, despite the relatively limited scope of the U.S.-Nepal Agreement, it had a symbolic value. It was signed at a time when there was virtually no foreign private investment in Nepal except Indian investment, and its conclusion stimulated closer examination of the importance of capital import for economic development. The guaranty agreement alone could not lead to significant change. The volume of U.S. investment in Nepal remains limited,⁹⁴ but it helped to lay a foundation for the future elaboration of a national regime on foreign investment.

Second, the Germany-Nepal, France-Nepal and U.K.-Nepal agreements are relatively current compared with the U.S.-Nepal Agreement. They reflect the development of investment practices in the world. These agreements also have psychological importance: they demonstrate the willingness of developed countries in the West to cooperate economically with Nepal through private investment ventures. Moreover, the ideas embodied in the agreements, especially those involving modern investment practices, made the concept of foreign private investment clearer, not only to the state but also to the potential Nepalese investors. Nevertheless, from a pragmatic viewpoint, the agreements still represent

89. France-Nepal Agreement, *supra* note 82, art. 8; Germany-Nepal Treaty, *supra* note 83, art. 11; U.K.-Nepal Agreement, *supra* note 84, art. 8. It should be noted that Nepal signed the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID), Sept. 28, 1965, 575 U.N.T.S. 159 (1965). After the deposit of the instrument of ratification on Jan. 7, 1969, the Convention entered into force for Nepal on February 6, 1969. LIST OF CONTRACTING STATES AND OTHER SIGNATORIES OF THE CONVENTION, U.N. Doc. ICSID/3 (Nov. 1993).

90. France-Nepal Agreement, *supra* note 82, art. 11; Germany-Nepal Treaty, *supra* note 83, art. 11; U.K.-Nepal Agreement, *supra* note 84, art. 9.

91. France-Nepal Agreement, *supra* note 82, art. 11.3; Germany-Nepal Treaty, *supra* note 83, art. 11.3; U.K.-Nepal Agreement, *supra* note 84, art. 9.3.

92. France-Nepal Agreement, *supra* note 82, art. 11.3; Germany-Nepal Treaty, *supra* note 83, art. 11.3; U.K.-Nepal Agreement, *supra* note 84, art. 9.3.

93. France-Nepal Agreement, *supra* note 82, art. 11.5; Germany-Nepal Treaty, *supra* note 83, art. 11.5; U.K.-Nepal Agreement, *supra* note 84, art. 9.5.

94. For instance, for 1987, more than two decades after the agreement, out of NR 189.9 million total investment for Nepal, U.S. investments accounted for only NR 15.8 million. See *Asia and the Pacific*, in 1 WORLD INVESTMENT DIRECTORY 182 (1992).

a one-way relationship; Nepalese citizens are not yet allowed to export capital.⁹⁵ This is perhaps why the outward investment position of Nepal is very low.⁹⁶

c. Indo-Nepal Investment Relations

Despite the liberal attitude adopted by Nepal to attract private foreign investors, as reflected in the investment laws and bilateral agreements, the volume of investment by parties other than India remains extremely low.⁹⁷ The volume of Indian investment, however, is growing daily and becoming increasingly significant. There are several reasons for this increased investment.⁹⁸ First, the geographical proximity between Nepal and India and the open border system facilitates imports and the flow of capital. Second, the similarity of Indian and Nepalese markets ensures that the Indian investors are more aware of the problems and prospects of the Nepalese market. Third, and most important, is the applicable regime that has been in force since the conclusion of a special treaty between India and Nepal in 1950.⁹⁹ Article 6 of the treaty provides:

Each government undertakes in token of neighborly friendship between India and Nepal to give to the nationals of the other, in its territory, national treatment with regard to participation in industrial and economic development of such territory and a grant of concessions and contracts relating to such development.¹⁰⁰

95. The Nepalese policies on the outflow of capital have always remained ambiguous. A 1964 Act prohibited the exportation of capital. See UPRETY, *supra* note 52, at 225. The Act although lacking in enforcement was never repealed. Moreover, restrictions on foreign currencies imposed by the Foreign Exchange Act render impractical the export of capital. This is true with regard to all countries other than India. A special relationship exists with India, and no such restrictions are applicable. Interestingly, however, even under these circumstances, a few cases of Nepalese investment in other countries can be found. This also shows that some laws are indeed archaic and far from being enforced, which demands that proper revision and adjustments consistent with reality be made.

96. See *Asia and the Pacific*, *supra* note 94, at 180.

97. The main reasons for noninvestment or extremely low investment are, inter alia, the following: (1) a very limited domestic market without enough outlays for goods, (2) a very limited capital market which makes raising funds in the domestic market difficult, and (3) lack of a trained and skilled workforce. See generally UNCTAD, TRANSFER AND DEVELOPMENT OF TECHNOLOGY IN NEPAL: POLICY AND INSTITUTIONAL ISSUES, U.N. Doc. TT/80 (1985).

98. For details on Indian investments in Nepal, see P.C. RAWAT, INDO-NEPAL ECONOMIC RELATIONS 220-25 (1974).

99. The Indo-Nepal Treaty of Peace and Friendship, July 31, 1950, India-Nepal, 94 U.N.T.S. 3 [hereinafter Indo-Nepal Treaty].

100. See *id.* art 6.

This liberal provision may be considered the reason for the import of Indian capital into the market.¹⁰¹ This provision is further reinforced by article 7, which states:

The governments of India and Nepal agree to grant, on a reciprocal basis, to the nationals of one country in the territory of the other, the same privileges in the matter of residence, ownership of property, participation in trade and commerce, movement and other privileges of a similar nature.

This kind of unequivocally preferential treatment has been extremely helpful for the growth of capital inflow from India into Nepal.

This history leads to another conclusion: Even in the absence of a formal bilateral investment treaty investment can prosper. The overwhelming nature of Indian investment in Nepal, as opposed to the limited scale of investment from the United States, Germany, or France, despite bilateral investment treaties, substantiates this observation. The Indian investments are indeed important not only in capital, but also in scope.

Even after the conclusion of the bilateral investment agreements that provide for treatment comparable to that guaranteed by other existing standard international investment treaties, the volume of investment from Germany, France, and the United Kingdom has not increased significantly. Due to the preferential treatment that Nepal and India grant on a reciprocal basis, Indian investors have a distinct advantage over other investors. This advantage exists despite the confidence generated by bilateral agreements with France, Germany, the United Kingdom, and the United States.¹⁰²

7. Risks to Foreign Investment

a. Nationalization or Expropriation

According to the Industrial Enterprises Act, enterprises are generally not nationalized. Nevertheless, the Act does provide for the possibility of nationalization under special circumstances and outlines compensation that is to be paid

101. Although this treaty was not exclusively meant to governing foreign investment, it did have a very direct impact on increasing the volume of Indian investments in Nepal.

102. France-Nepal Agreement, *supra* note 82, arts. 2, 4; Germany-Nepal Treaty, *supra* note 83, art. 3(3); U.K.-Nepal Agreement, *supra* note 84, art. 7. All three specify that the treatment, most-favored-nation (MFN) status, provided for by the agreements does not extend to privileges which either contracting party accord to nationals or companies of third countries on account of membership in, or association with, a customs or economic union, a common market or a free trade area. France-Nepal Agreement, *supra* note 82, arts. 2, 4; Germany-Nepal Treaty, *supra* note 83, art. 3(3); U.K.-Nepal Agreement, *supra* note 84, art. 7. These provisions clearly exclude, therefore, the Indo-Nepal Treaty from the scope of application of MFN.

based on just evaluation.¹⁰³ The words "under special circumstances," of course, leave room for confusion, and the government is granted excessive discretionary power to interpret the phrase. This ambiguity is reduced by the Foreign Investment and Technology Act.

According to section 13 of the Foreign Investment and Technology Act, industrial enterprises or industrial property will not be nationalized except to safeguard the national defense and other national interests. The Act also provides for just compensation to parties where property rights are abrogated.¹⁰⁴ Compensation is to be made in foreign currency at the prevailing rate of exchange.¹⁰⁵

b. State Intervention

The Nepalese investment law frequently allows direct government intervention. According to the Foreign Investment and Technology Act, for instance, government authorization is required to obtain foreign loans, increase investment from foreigners, conclude technology transfer agreements, change industrial capacities, and initiate other forms of modernization.¹⁰⁶ An enterprise cannot make any major decision without the government's prior approval; obtaining approval can be a difficult, lengthy, and costly process for the enterprise.

Similarly, the government can issue mandatory directives to industry. These directives may concern issues relating to: quality standards, prices, and distribution of products or services; management of the enterprise; maintenance of labor relations; public interest and welfare; or environmental protection and measures against pollution.¹⁰⁷ The Act also permits the government to initiate sanctions such as fines, the suspension of privileges, and even to order the closure of the enterprise.¹⁰⁸

The provisions of the Act demonstrate the willingness of the legislature to increase state control over foreign investment. This intervention, in a country that

103. Industrial Enterprises Act, *supra* note 35, § 11.

104. Compensation for nationalization or expropriation of property is also covered, in a limited manner, in the Nepal constitution. Although it primarily concerns the right to property, the constitution mentions that "the basis of compensation and procedure for giving compensation for any property requisitioned, acquired or encumbered by the State in the public interest shall be prescribed by law." NEPAL CONST. art. 17. Two points, however, should be noted. First, the constitutional provisions do not establish any principle for compensation. Second, it is ambiguous whether this right to property is granted to citizens only or to aliens as well. Similarly, it is unclear whether the provision is applicable to corporate bodies. Whatever the case, one point is clear: The constitution has endorsed the notion of compensation for expropriation of any kind of property.

105. FITA, *supra* note 27, § 10(e).

106. *Id.* § 7.

107. *Id.* § 14.

108. *Id.* § 16. Under the present legal system in Nepal, there is nothing that resembles antitrust law. In theory, the government is not hostile towards large corporations, but there is de facto control of monopolies based on price control, price stabilization, tax measures, and the like.

should give highest priority to industrialization, may not be appropriate. Investors may hesitate to start long-term projects in such an unsure and vulnerable legal environment where government agencies seem to exercise unlimited discretionary power.

III. PRIVATE FOREIGN INVESTMENT AND TECHNOLOGY TRANSFER

As pointed out earlier, one of the principal reasons for the government to encourage foreign investment is to promote technology transfer.¹⁰⁹ Nepal depends on imported technology for modernization. The reason for promoting technology transfer is therefore understandable, but this emphasis has also created disequilibrium. Transactions are not always on equal footing. Indeed, because of the limited experience in technology transfer or other related operations, as well as lack of information about the investment practices in the world, Nepalese investors may be relatively weak in negotiations and may limit their demands.

In general, technology transfer takes place in a number of ways; for example, through banks, journals, industrial fairs, technical cooperation, the migration of skilled people, and so on. However, such direct transfers of technology are quite uncommon. The most common method is the indirect route of transfer by equipment, industrial properties such as patents and trademarks, skilled labor, equity capital, joint ventures, licensing, management contracts, turnkey projects, or the installation and servicing of purchased industrial equipment, commonly known as "package technology."¹¹⁰ The law reflects the priority granted by government policy to the technology transfer. The Foreign Investment and Technology Act, for instance, deals with such transfers. The importance granted to the transfer of technology by law and policy, however, is minimized in practice. The following paragraphs deal briefly with the status of technology transfer in the present Nepalese context.

The Foreign Investment and Technology Act defines transfer of technology agreements in the following terms:¹¹¹

Transfer of technology agreement means an agreement between an enterprise and the foreign investor in respect of the (i) use of any technologi-

109. Perhaps Nepalese policy focuses too much on technology transfer and not enough on capital investments. Foreign private investment is considered primarily a vehicle for technology transfer. This policy preference has engendered difficulties for capital imports.

110. See generally UNIDO, NATIONAL APPROACHES TO THE ACQUISITION OF TECHNOLOGY; DEVELOPMENT AND TRANSFER OF TECHNOLOGY, United Nations, Series no. 1, at 5-8 (1977).

111. The Act does not adequately define "technology." It would therefore be useful to add a definition that is clear and would help recognize and reflect the technological needs of the country. An example of a relatively clear and complete definition is the one given by Feinrider: "Technology, both patented and unpatented, relates to product, production process and facilities design, and management technique. It also includes franchise methodology, conventional technology, know-how and high technology." See M. Feinrider, *UNCTAD Transfer of Technology Code Negotiations: West & East Against the Third World*, 30 BUFF. L. REV. 753, 757 (1981).

cal right, specialty, formula, process patent or technical know-how; (ii) use of trade mark; and (iii) acquiring services on technology, consultancy, management and marketing.¹¹²

It is appropriate to mention that technology transfer transactions between private Nepalese parties and foreign investors are generally based on short-term rather than long-term contractual relations.¹¹³ In these transactions, foreign suppliers profit through sales of machines and services. The entire risk is borne by the Nepalese party. In other words, for foreign suppliers of technology, the transfer is made at a very low risk.

A. Contractual Transfer of Technology

"Contractual transfer" is a common method for transferring industrial technology in Nepal; it includes both public and private enterprises.¹¹⁴

1. Types of Contractual Transfer

As chronicled in the official records of the Ministry of Industry, contractual transfer of technology takes place in both the hotel and the manufacturing industries, often in the general form of a "package," more commonly called "package technology." This method consists of technical assistance, engineering counseling, training, provision of machines and raw materials, and the use of trademarks or trade names. In this context, the primary concern of the supplier of technology is likely to be the control of the marketing aspect of the venture.

Contracts for technology transfer take three forms: technical assistance, marketing and management, and transfer of patent rights.

a. Technical Assistance Contracts

Technical assistance contracts are the most common mode of technology transfer. They generally concern consumer products and deal with process know-how, trademark use, and technical or management counseling.

Technical assistance contracts generally involve two areas: information and the technical package. The informational assistance includes preparation of facilities, documentation, specifications, and other general technical information.

112. FITA, *supra* note 27, § 2(d).

113. K. Uprety, *Transfert de Technologie au Nepal: Quelques Aspects Politiques et Juridiques*, 8 INT'L BUS. L. REV. 819 (1986).

114. The number of "license agreements" remains limited, although it increases every year. The increase is primarily the product of new investment policies, a decrease in foreign grants, and the need to modernize existing enterprises. See generally Uprety, *supra* note 113, at 820.

The technical package concerns provision of experts, training of Nepalese personnel, coordination and supervision of the operation, and construction of the infrastructure. These contracts also deal with trademark use. The use of a trademark often helps prolong the contract beyond the period of actual technical assistance. During the period of trademark use, the Nepalese parties are required to buy raw materials or other intermediary products from the suppliers.

b. Management and Marketing Contracts

In the case of management and marketing contracts, licensees are usually interested in exclusive marketing rights. Control is generally obtained through equity participation and investment in capital.¹¹⁵ One of the serious problems resulting from this kind of contract is the dependence of the Nepalese companies on the marketing information provided by the suppliers, especially in the areas of training and know-how.

c. Transfer of Patent Rights

In contracts dealing with transfer of patent rights, the Nepalese companies are required to pay a royalty on the turnover in addition to a commission on each item produced. The licensee is obliged to stop all production at the end of the contract period. Foreign control thus appears omnipresent and restraining. This is probably because the Nepalese companies are in a relatively weak position when negotiating with foreign suppliers of technology, who are often more experienced.

2. Characteristics of Foreign Control

In most contracts between a Nepalese and a foreign party, foreign control is arranged in two ways. In some cases, the nature of control is clearly spelled out in the contract; in others, the control is reinforced through direct control of capital.

In general, there are five forms of payment for the technical information and know-how transferred: total payment, commissions, royalties, sales tied to raw materials on intermediate goods, and profit on sales percentages. A "discovery payment" may also be added to the first two payment methods. In marketing contracts the payments are generally guaranteed by exclusive sales rights.

One interesting point is that the contracts often fail to specify the responsibilities of the technology suppliers. Moreover, although the knowledge is provided free of charge, the supplier is not held responsible if it does not achieve the goals

115. For a general account of management contracts, see Sven Olaf Hegstad & Ian Newport, *Management Contracts: Main Features and Design Issues*, TECHNICAL PAPER (World Bank) No. 65 (1987).

sought. The contracts usually provide many restrictions; for example, on exportation, personnel, technology to be used, and price ranges.

Finally, it can also be noted that the foreign party can ensure control through the accounts, information, and the quality of the item supplied. Other limitations may concern the use of information received, markets, and manufacture of other products based on the information provided.

3. Intellectual Property

Acknowledging that protection of industrial property has a direct impact on technology transfer, and recognizing the importance of protection of industrial property rights, the Nepal Patent, Design, and Trademark Act was introduced in 1965. It gives a fifteen-year, renewable and monopolistic protection to the patentees once they are registered with the Department of Industry.¹¹⁶

The review of patents and trademarks registered in Nepal leads to the following three observations: (1) registration is not yet made by product, process, or country of origin; (2) new existing patents are held by Nepalese citizens; and (3) consumer merchandise makes up most of the registrations.¹¹⁷

The records of the Ministry of Industries reveal four dominant patent practices. First, protection has been granted to virtually every item, irrespective of whether the patent was sought for a product or for a process. Second, the acceptability of an application did not appear to be influenced by any criteria, such as novelty or contribution to national technological development. An item patented in three countries is automatically patentable in Nepal.¹¹⁸ Third, there is no provision for determining whether the registered patent has been utilized in Nepal, or for preventing patents from remaining unexploited. Fourth, despite the very long protection period, renewal is granted to all patents without any further examination of the case.

It is clear that the patent law is based on a very old notion of patents, which implies the de facto creation of a monopoly.¹¹⁹ The patent system is not yet considered an important part of Nepal's industrial development.¹²⁰ Indeed, the Patent, Design, and Trademark Act of 1965 has a very limited coverage. A clear and acceptable definition of patent or patentable products incorporating other industrial property titles such as inventors' certificates, utility certificates, utility models, patents or certificates of addition, inventors certificates of addition, and utility certificates of addition, will be useful.

116. Patent, Design, and Trademark Act, § 8 (1965) (Nepal).

117. GOV'T OF NEPAL, RECORDS OF THE DEPARTMENT OF INDUSTRY (1990/1991). See NATIONAL LEGISLATION, *supra* note 21, at 116.

118. NATIONAL LEGISLATION, *supra* note 21, at 116.

119. See UNCTAD, *supra* note 97.

120. For detail, see Uprety, *supra* note 113.

The Nepalese industrial sector has evolved in the kind of legal environment outlined here. The government has been without a clear-cut policy or legal regime and has constantly emphasized the transfer of technology, while the concerned parties have tried to negotiate with the investors and suppliers of technology for better conditions. The majority of investment enterprises deal one way or another with the transfer of technology. The following section briefly presents the features of such agreements.

B. Specific Features of the Technology Transfer Agreements Concluded by the Nepalese Private Enterprises

At the outset, it should be pointed out that it is extremely difficult in Nepal to consult and examine the legal documents relating to the required transactions. They remain either "top secret" and cannot be approached, or they simply give a very general outline, similar to most classical agreements, and therefore are not of great use in a comparative survey. Whatever the difficulty, the few technology transfer agreements the authors have consulted show some interesting characteristics.¹²¹

The first helpful point is that in most joint venture agreements, the technical area is fully controlled by the technology supplier. The recipients, Nepalese parties, have local responsibility. For instance, they maintain liaison with the local institutions and carry out activities that are required for the establishment and continuation of the joint venture, including procurement for the factory premises, clearing from port, and forwarding to the factory all machineries, raw materials, and so on. In some agreements, the local party had the right to "give advice" on the sales and marketing of products to be manufactured or services sold by the company.

An overview of the technology transfer agreements concluded in the 1980s shows that through increased participation in the decision making, the involvement of indigenous partners had gradually become important. Most of the contracts signed before 1980 showed that the role of the local party in the decision-making process of the company was limited by an array of controlling mechanisms.

It also can be noted that in all of the agreements relating to management and marketing, the local parties engage the foreign party to be the exclusive operator of the particular company. These collaborations are most common in the tourism

121. The study was completed at the end of 1990 and reviewed about 15 contracts, primarily in the travel sector (including hotel and restaurants), with a few manufacturing enterprises included. Presently, there are a little more than 100 joint ventures operating or registered in Nepal, but the great majority of the foreign companies involved are Indian. A detailed list of foreign collaboration ventures appears in FOREIGN INVESTMENT OPPORTUNITIES, *supra* note 2, at 31-34.

business. Although this exclusivity is in extreme favor of the foreign investor, these agreements have shown better results in profitability.

Trademarks are dealt with in most of the agreements. The importing parties agree that they will acknowledge and recognize, before and after the expiration of the agreements, the exclusive right of the foreign party to use or to grant to others the right or license to use the trademark or trade names.

With regard to the royalty, this may be due to the lack of experience of the Nepalese parties in negotiating these types of agreements, or due to the difficult market-assessment situation. As a consequence, many contracts lack clarity. Three areas of royalty, however, may be identified: global royalty according to the governmental evaluation; royalty proportionate to the total revenue of the company; and predeclared royalty decided upon by both the parties during negotiations.

Most agreements contain special clauses with the right of first refusal. The Nepalese parties agree not to sell or otherwise dispose of the company to any other person or corporation without first offering the company to the foreign party at a price or rental and on terms no less favorable than those the Nepalese party is willing to accept from a third party.

Another feature is that some of the joint ventures as well as transfer of technology agreements do not contain arbitration clauses. They refer only to the application of Nepalese law, without prescribing arbitration, which is now quite common. Such is not the case in the management or service agreements, which refer to the arbitration rules of the International Chamber of Commerce.

It may be concluded from the above that a relatively serious disequilibrium exists in the relationship between the foreign investor or supplier of technology and the local recipient, which places the local party in a disadvantageous position.

IV. CONCLUSION

As an overall assessment, we may say that, although still in the process of formative evolution, the regime of foreign private investment in Nepal may be hailed as relatively liberal and satisfactory from a foreign investor's viewpoint. Indeed, some authors have qualified the laws governing foreign investment as not yet sufficiently developed.¹²² However, the present authors maintain that although there are some limitations, the laws governing foreign investment, in the aggregate, are not unduly restrictive. No doubt, the country has made a concerted effort in recent years, particularly in the late 1980s, to improve its investment climate; it has also been successful in accommodating the notions of contemporary investment practices with the industrial and economic development needs of the country. The relative success of the country's industrialization

122. See Thapa, *supra* note 37, at 9.240.27.

strategy may best be measured by the confidence implied by the limited, but gradual increase of foreign investment, especially after the mid-1980s.¹²³

Nevertheless, there is room for improvement. For instance, too many scattered legislative acts currently govern the regime of private foreign investment. It would be advisable to prepare a "framework law" that would cover all aspects relevant to private foreign investment. In other words, all forms of foreign investment should be brought under the provision of one law. This would not only facilitate the understanding of the regime by foreign investors, but would also reduce the discretionary power that the government exercises in interpreting the legal and policy provisions.¹²⁴

Similarly, the absence of up-to-date codes covering tax, customs, financial management, export-import, or business enterprises has handicapped the state administration. The proliferation of decrees, regulatory statutes, and administrative notices that are often inconsistent with the spirit of equal treatment between foreign and national investors, or that are obscure, create uncertainty, and result in delays or the disregard of enactments by the state apparatus itself. Furthermore, because of the abstract and often vague language, the acts fail, in their entirety, to disclose clear-cut answers to the problems involving foreign investment.

The revamping of investment laws, therefore, will certainly help reduce such gaps. In this context, the Guidelines on the Treatment of Foreign Direct Investment prepared by the World Bank Group may be of great relevance and useful for this purpose.¹²⁵

At the same time, some inconsistencies between the bilateral legal arrangements made by the country or by private parties and the existing laws governing foreign investment are also obvious. One of the examples is related to the settlement of disputes. The Foreign Investment and Technology Act, for instance, refers to the UNCITRAL rules, while the agreements signed by the Nepalese parties refer to the International Chamber of Commerce rules and the bilateral investment treaties refer to ICSID.

A foreign investment and technology transfer system has two components: regulation and promotion. Regulations on investment are generally designed to extract the maximum benefits from investment, while promotional measures are designed to increase the total amount of investment flowing into the country.¹²⁶

123. Foreign private investments amounted to NR 252.1 million in 1988, as opposed to NR 167 million in 1985. WORLD INVESTMENT DIRECTORY, *supra* note 94, at 181.

124. The Guidelines on the Treatment of Foreign Investment prepared by the World Bank encourages all nations to publish, in the form of a handbook or other medium easily accessible to other nations and their investors, adequate and regularly updated information about its legislation, regulations, and procedures relevant to foreign investment and other information relating to its investment policies. *See generally* Guideline No. II.6 in Development Committee, *Guidelines on the Treatment of Foreign Direct Investment*, 7 ICSID REV.—FOREIGN INVESTMENT L.J. 300 (1992).

125. *Id.*

126. FORMULATION AND IMPLEMENTATION OF FOREIGN INVESTMENT POLICIES, U.N. Pub. ST/CTC/SER.B/10 at 5 (1992).

Nepal, to date, has not been able to establish a successful technology transfer system. For example, its reference in the Foreign Investment and Technology Act is too brief to be complete and clear. Further, as discussed in this paper, a serious lack of uniformity as well as disequilibrium exists.

It is essential to improve the regime applicable to the transfer of technology along with that of industrial property in general. Much remains to be done to enable Nepal to import, absorb, and use technology in a planned and intelligent manner.

In spite of the few minor shortcomings examined briefly throughout this article, the balanced model of industrialization through investment applied by Nepal should be considered as relatively effective. The country's success in attracting increased levels of foreign investment now depends on the capability of the government to maintain political stability.